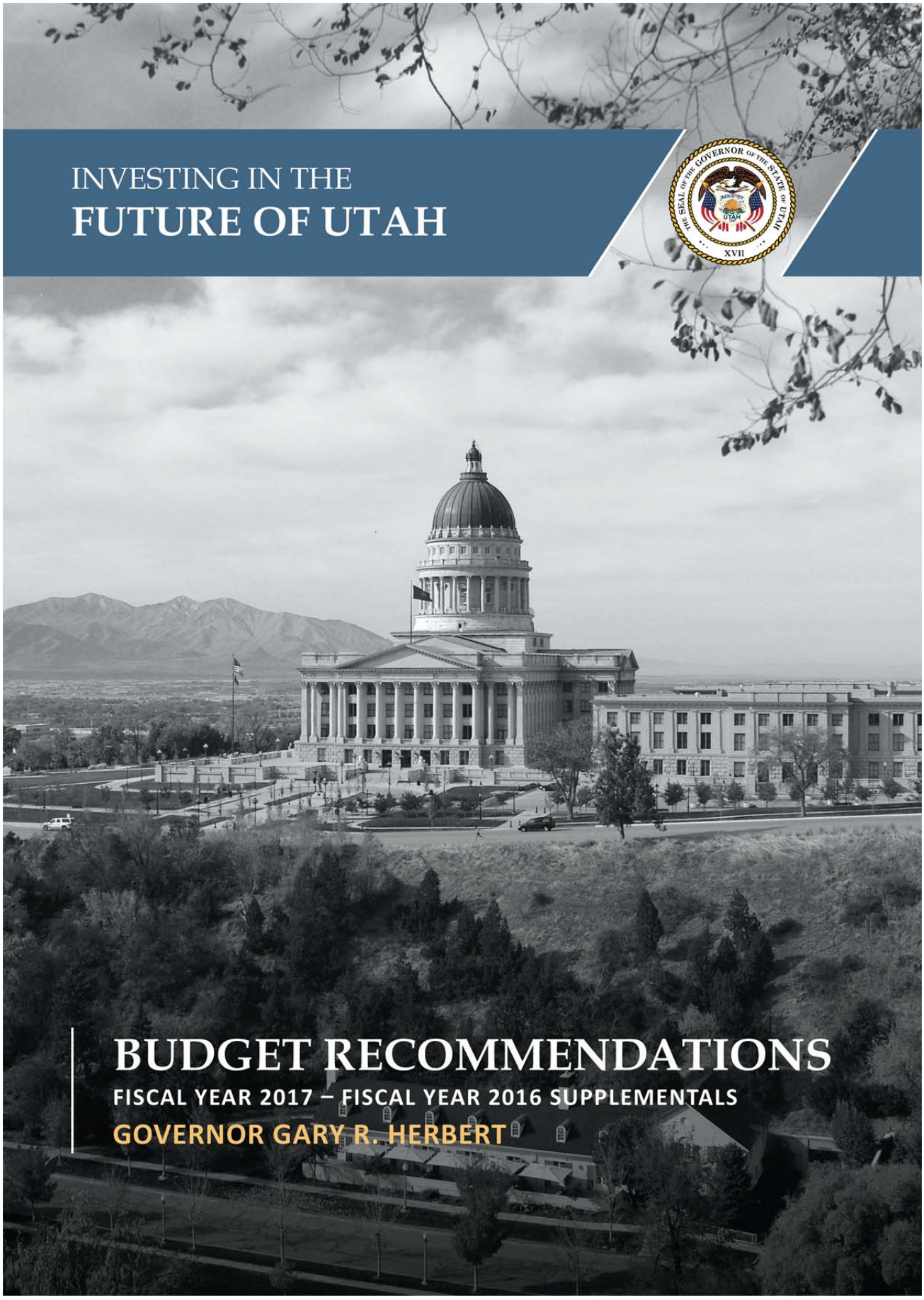


INVESTING IN THE
FUTURE OF UTAH

BUDGET RECOMMENDATIONS

FISCAL YEAR 2017 – FISCAL YEAR 2016 SUPPLEMENTALS

GOVERNOR GARY R. HERBERT

BUDGET & POLICY BRIEF

WATER

HIGHLIGHTS

- **$6 million** (including $4 million General Fund) to collect data and study water use throughout the state
- **$460,000** to improve water data reporting processes
- **$300,000** to invest in technology to improve state facility water conservation
- **$300,000** for water conservation advertising and rebates
- **$523,000** for water rights adjudication to improve water rights certainty
- **$800,000** to help ensure safe drinking water
- **$130,000** for an inventory of canals

OBJECTIVE

To develop water funding policies and mechanisms that ensure:

- the State of Utah maintains a financial role that is fiscally prudent and sustainable;
- a sufficient, safe, and reliable supply of water meets appropriate usage levels for a growing population and balances residential, commercial, recreational, agricultural, and environmental uses;
- Utah's limited water resources are wisely being used;
- an appropriate alignment exists between the costs of water and the use of water;
- the water quality of our lakes, rivers, and streams is protected; and
- policymakers make informed financial decisions regarding water based on accurate and reliable data.

BACKGROUND

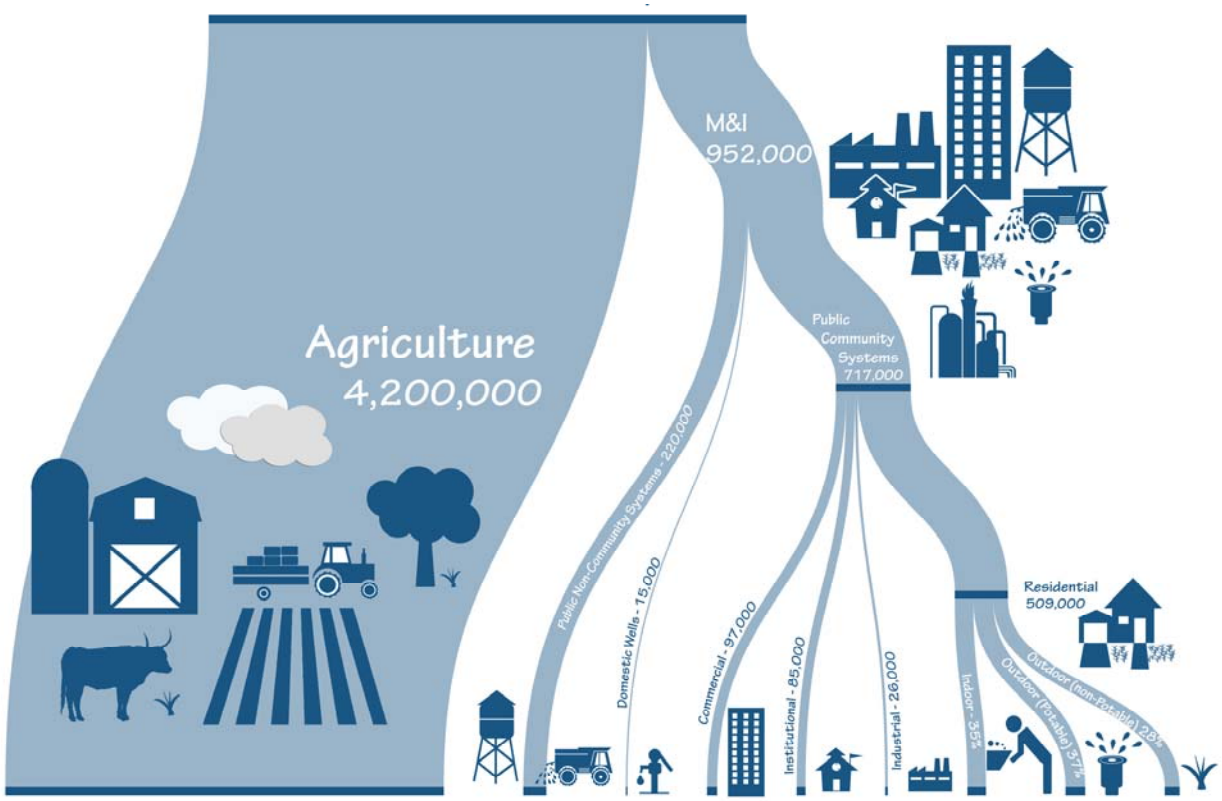
As one of the driest states in the country, water is always a topic of concern within Utah. Although the state as a whole is very dry, most of Utah's major population centers enjoy favorable circumstances with higher precipitation rates than the state average and close proximity to mountains and their even higher precipitation and snowpack. Snowpack offers a clean, annually renewed water source that is largely delivered by gravity to the state's major population centers. Some projections suggest future changes in weather patterns and precipitation could affect snowpack.

WATER USE

Figure 1 shows the distribution of diverted water in Utah. Diverted water is generally categorized into agricultural water (estimated 82%) and municipal and industrial (M&I) water (estimated 18%). Of the 18% of diverted water that is M&I, an estimated 3.5% of the statewide total is residential indoor use; 6.5% residential outdoor use; 2.5% commercial and industrial use; 1.5% institutional use (such as governments and schools); and 4% public non-community use, which includes certain industrial uses.

Recognizing that water use data reporting among states is imperfect and sometimes based on inconsistent methodologies, the U.S. Geological Survey indicates that Utah has the highest per capita M&I water use in the nation. The State of Utah should continue to push for better data that provides for better water use comparisons within Utah and among other states.

FIGURE 1 – WATER DISTRIBUTION IN ACRE FEET PER YEAR



Looking to the future, policymakers should take a comprehensive view of water and seek to improve the efficient use of water across the board. Recognizing that any change must protect existing water rights and include proper economic incentives, relatively minor percentage increases in agricultural efficiency could have a dramatic impact to water use overall.

For example, a true 5% efficiency increase in agricultural water use (after return flow) could provide an amount equal to current statewide indoor water use. The ability to shift this agricultural water use to M&I use would depend on the geographic location, with some water being cost prohibitive to move to other locations. In addition, as agricultural land is converted to residential and commercial uses, the water is generally converted to M&I use.

WATER INFRASTRUCTURE

The State of Utah itself does not own major water delivery infrastructure. Rather, water has historically been a local responsibility, generally through local government entities and some private providers. Local water wholesalers and water retailers develop water sources and deliver water to the end user. In some cases, local water providers have neglected to build sufficient revenues into their water prices to cover the repair and replacement of infrastructure—one of the several reasons for Utah's low water rates. Another reason is the practice of using property taxes (rather than user fees) to pay for a portion of water costs.

Future population growth and local repair and replacement costs will likely result in increased future water costs. The easiest and least

expensive water development projects have already been completed. Future projects will be very costly due to the nature of the projects themselves, as well as increased environmental review and permitting processes.

With Utah's projected population growth in mind, policymakers, water providers, and water users must work together toward solutions that lead to much greater conservation of existing developed water; use existing infrastructure more efficiently; and develop future water in ways that are fiscally and environmentally sustainable.

Assuming that current water usage levels continue as-is or only minor additional conservation occurs, the demand for M&I water is projected to exceed supply over the coming decades as Utah's population continues to grow. Utahns have an important choice to make about water use. The need for additional water supply at some point is a given; however, the timing of water system development varies dramatically depending on changes in water usage. Increased conservation could delay major development projects for decades while the failure to conserve water will lead to accelerated building schedules and their associated increased costs sooner.

As previously mentioned, the U.S. Geological Survey indicates that Utah has the highest per capita M&I water use in the nation, even though Utah's water use has been estimated to be 18% lower than the reported water use in a 2000 report commonly used as a benchmark. Some existing projections assume little to no improvement in the efficient use of water after 2025. If Utah's water were used more efficiently, the need for costly water development projects could be postponed for decades. However, if water use continues as-is or there are only minor additional conservation efforts put into place, Utah will likely need to develop costly water supply systems in the near term.

Currently, about $36 million is earmarked from state sales tax for water—an amount that automatically increases with an increase in sales tax revenues.

WATER CONSERVANCY DISTRICT FUNDING REQUEST

Considering current per-capita usage, projected population growth, and the condition of infrastructure, a group representing large water conservancy districts has identified $33 billion in water projects they believe should be built in the state over the next 45 years ($18 billion in repair and replacement projects and $15 billion in new projects). In some cases, a fair amount of detail has been provided on the projects while in other cases minimal detail is available. Given the very long time period for these estimates, the dollar amounts provided should be considered a very rough approximation of future water project costs.

Under the water conservancy district proposal, existing local revenues would cover some of the projects and new local revenues in the form of property taxes or user fees would also be required to cover all future water projects identified. The proposal also suggests that state tax revenues cover roughly $12 billion of the estimated $33 billion.

Although the requested General Fund amount for this year is currently at $35 million, the original plan called for $100 million of ongoing revenue to be allocated for these projects and it is likely that similar large dollar amounts will be pursued in the future.

Under the water conservancy district proposal, the State of Utah would allocate state General Fund tax revenues and issue state bonds to pay for billions of dollars in major water development projects. The State of Utah would pay for all project costs up front, with repayments to the state delayed to

begin from one to ten years after completion of construction, depending on when water is supplied. Given the state's 20 year bonding limit on general obligation bonds, this means that state taxpayers would largely pay for the bond prior to full annual repayment to the state beginning.

The Lake Powell Pipeline Act (enacted in 2006) and the Bear River Development Act (enacted in 1991) indicate that the projects are subject to future funding decisions. Under the acts, once projects are built, and repayments to the State of Utah begin, full repayment would not be reached for over 50 years. Repayments for 70% of the project costs would be made within 50 years after local entities take water that was contracted for prior to construction. However, the remaining 30% of project costs are completely open-ended, meaning no set time period is in place for repayment to the state, although this portion of the water must be repaid within 50 years after the water is taken. Repayments to the state would be made at an indeterminate interest rate, which could be less than the state's borrowing costs. Under the proposal, the State of Utah's General Fund would never be repaid and the ongoing allocation of tax revenues would create a permanent sizable state taxpayer subsidy for water development.

The request of the conservancy districts is essentially for the State of Utah to assume the role of financing water projects which was previously filled by the federal government. It should also be recognized that allocating state tax revenues for major water development projects constitutes a massive expansion of the state's role. Unlike the federal government, the State of Utah balances its budget. This means that this type of major funding expansion would ultimately affect other state-funded programs (in particular education) or future tax levels.

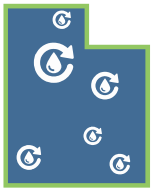
Out of respect to the taxpayer, it is recommended that the State of Utah only allocate very scarce General Fund resources to financing major water projects after all other alternatives are exhausted (similar to how other budget requests are treated) and the significant concerns raised in the recent legislative audit on water are resolved. Of particular concern is the current pressure to the General Fund in meeting core existing state government functions.

Prior to undertaking a major expansion to the state's role in water project funding, the following minimum conditions should be met:

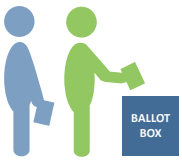
Better water data and data reporting

New and meaningful water conservation targets

Independent validation



Local funding effort and increased emphasis on user fees



Transparency and local voter engagement

Appropriate financing and repayment terms

The details of these minimum conditions include:

- Better water data and data reporting prior to any state financing or funding, including universal metering of water in all areas that would receive state-funded water and three years of data reporting of water usage under new state reporting standards to be implemented in 2016.
- Building upon previous efforts, the implementation of new and meaningful water conservation targets that strongly emphasize improved water conservation, including reductions of government water use.
- Independent validation, including a comprehensive price elasticity and repayment feasibility study, reporting of water use data in CAFRs, and independent validation of project costs.
- Local funding effort and increased emphasis on user fees, including local conservancy districts paying up front for a meaningful portion of the project itself (for example, the federal government required a 35% local contribution on recent projects); water rates that reflect a local water user effort demonstrating a strong local commitment when compared with the water rates of other state taxpayers that will be paying to finance the projects and that fund needed local repair and replacement projects; and movement away from property taxes in favor of user fees for water (which will enhance economic incentives for conservation).
- Transparency and local voter engagement through public processes, including public hearings disclosing projected water rate increases and a local vote agreeing to the project and associated state repayment, including needed rate increases.
- Appropriate financing and repayment terms, including all interest capitalized into the loan; an interest rate set in statute that reflects the state's borrowing costs (given the long repayment period, either adjusting for inflation or adjusting over time to reflect the state's latest borrowing rate); set repayment period for 100% of the project costs; payments that at least partially begin concurrently with the state's bond repayment; and repayment directly to the state General Fund rather than a revolving loan fund so that the legislature has the ability to prioritize each water project against other state priorities.

Recognizing that the projects are not currently funded and that current statutes will require changes, ongoing discussions will be needed to ensure appropriate terms are put in place prior to the state allocating additional funds for these purposes. The Governor recognizes the positive efforts of stakeholders to date in encouraging conservation, striving for improved water use data, and planning for the future and welcomes the opportunity to continue to work together to find solutions that meet the appropriate water needs of a growing population in a fiscally prudent and conservative way.

GUIDING PRINCIPLES

- The State of Utah should take a comprehensive view of water management. Policies and strategies must be developed or better implemented to encourage all water users (residential, commercial, agricultural, and government) to conserve water. Strategies include enhanced public education, meaningful price signals, use of emerging water-saving technologies, increasing wastewater reuse, encouraging water-wise landscaping, and the elimination of conservation barriers in local and state laws. Solutions should recognize the increasing value of limited water resources as growing demands stress existing supply and maximize the efficient use of existing water infrastructure and supplies.
- Better data and greater transparency into water usage and funding sources to help

policymakers and consumers make informed decisions on how best to use and conserve water. Better information and market price signals such as user fees will allow market forces to influence the use and conservation of water.

- Local governments should implement plans to locally fund the repair and replacement of local infrastructure, in particular when receiving any state taxpayer funding or financing. The State of Utah should adjust its policies to remove any obstacles, real or perceived, to local entities setting aside funds to repair and replace their water infrastructure.
- Funding responsibility should increasingly shift to end users. State involvement should be prudent and fiscally sustainable. Further earmarks should not be used. When state funds are provided to assist water development, local recipients should meet basic criteria such as planning, maintenance, appropriate rate structuring, and conservation to advance the state's overall water goals. The state should continue to support conservation strategies and education.
- The state water engineer must have the administrative and legal tools sufficient to efficiently enforce water rights law. The state should improve its water right adjudication process to clarify which water rights are valid and bring more certainty and speed to water transactions.
- Increased use of private financing sources for water development projects should be encouraged.

BUDGET RECOMMENDATIONS

- $6 million one-time, including $4 million General Fund, to collect data and study water use throughout the state, including advanced metering to measure water use in selected areas
- $460,000 ($320,000 ongoing and $140,000 one-time General Fund) to improve water data reporting processes from local government to state agencies so that policymakers have better information available to make major financial decisions
- $300,000 one-time to invest in water-wise technology to improve water conservation at state facilities
- $300,000 one-time from an increase in the water conservation earmark for water conservation advertising campaigns and rebates
- $523,000 ($375,000 ongoing to include $100,000 from water earmark increase and $148,000 one-time) for water rights adjudication to improve certainty around water rights
- $800,000 to help ensure safe drinking water
- $130,000 to finalize an inventory of canals in the state